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Supreme Court of the United States.

October Term, 1928.

No. 748

CARL H. KOTHE, Trustee,
APPELLEE, PETITIONER HEREIN,

v.

R. C. TAYLOR TRUST,
APPELLANT, RESPONDENT HEREIN.

In the Matter of
Herbert Turkel, Bankrupt.

Petition for Writ of Certiorari and Brief in Support of Petition.

FRANK H. PARDEE,
Attorney for Petitioner.

ADDISON C. GETCHELL & SON, LAW PRINTERS, BOSTON.

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Supreme Court of the United States.

OCTOBER TERM, 1928.

No.

CARL H. KOTHE, TRUSTEE,
APPELLEE, PETITIONER HEREIN,
v.
R. C. TAYLOR TRUST,
APPELLANT, RESPONDENT HEREIN.

IN THE MATTER OF
HERBERT TURKEL, BANKRUPT.

PETITION FOR WRIT OF CERTIORARI TO ISSUE TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

To the Honorable the Chief Justice of the Supreme Court of the United States and the Honorable Associate Judges thereof:

The petitioner, Carl H. Kothe, respectfully represents to this Honorable Court as follows:

1. The petitioner is the duly elected trustee in bankruptcy of the estate of Herbert Turkel, bankrupt. On April 20, 1927, the respondent entered into an agreement with the bankrupt to lease certain premises, described as a store and basement, No. 186 Front Street, Worcester, Massachusetts, commencing on the 15th day of May, 1927, for the full term of two years. The bankrupt agreed to pay rent

at the rate of $4000 yearly by equal monthly instalments. The bankrupt entered into and occupied the leased premises and paid rent under the lease until December, 1927, when an involuntary petition in bankruptcy was filed. No rent has been paid under the lease after January 15, 1928. The lease contained the following provision:

> "The filing of any petition in Bankruptcy . . . by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof."

2. This case arises from the fact that on April 3, 1928, the respondent filed with the referee a proof of debt (Rec. p. 1) for $5000, the amount of rent reserved in the lease from the last payment made under the lease to May 15, 1929, the date of expiration. The respondent by its representative re-entered the premises very soon after the filing of the petition, and has been in possession ever since.

3. The authority under which the jurisdiction of this Honorable Court is invoked is by virtue of the provisions of section 25 (*d*) of the Bankruptcy Act of 1898 and the amendments thereof.

4. The questions involved in this case, as stated in the dissenting opinion of Judge Anderson, are: *first,* whether the contract in question is on its face and in essential nature in fraud of future creditors of the prospective bankrupt, providing for proving false claims; *second,* whether the provision of the lease in question is a provision for a penalty, and not for liquidated damages.

5. Judge Lowell, in the District Court, sustained the ruling of the referee, who disallowed the proof of debt and aptly said: "If the claim is allowed the landlord may prove for the entire amount and then re-let the premises, perhaps at a higher rent." Upon appeal by the respondent the Circuit Court of Appeals for the First Circuit reversed the decree of the District Court dismissing the petition. Judge Anderson filed a dissenting opinion and in forceful and logical language (Rec. p. 15) agreed with the trustee's contention, the ruling of the referee, and the decree of the District Court.

6. The petitioner respectfully submits to this Honorable Court that his petition should be allowed for the following reasons:

(1) The questions involved in the case are questions of far-reaching importance to mercantile and business interests which have not been, but should be, settled conclusively by this Court.

(2) The said Circuit Court of Appeals by the majority opinion has laid down a doctrine which is untenable and in conflict with the weight of authority and the applicable decisions of this Court as to call for the exercise of this Court's power of supervision.

(3) The decision of said Circuit Court of Appeals is in conflict with the decisions of the Circuit Court of Appeals for the Sixth Circuit; in consequence it is desirable that the rule of law applicable be definitely and finally established by this Court.

Wherefore the petitioner respectfully prays that a writ of certiorari may be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the First Circuit, commanding said Court to certify and send to this Court a full and complete transcript of the record of all of the proceedings in this cause, to the end that said cause may be reviewed and de-

termined by this Court, as provided by law, and that it may have such other and further relief as to this Honorable Court may seem appropriate and in conformity with law.

Frank H. Pardee.

Attorney for Petitioner.

I hereby certify that I am counsel for the petitioner herein, Carl H. Kothe; that in accordance with the request of said petitioner and the referee in bankruptcy, Daniel W. Lincoln, Esquire, the foregoing petition has been prepared; and that the allegations contained in said petition are true to the best of my knowledge and belief; and that said petition is, in my opinion, well founded in law and in fact, and should be granted.

COMMONWEALTH OF MASSACHUSETTS.

COUNTY OF SUFFOLK, ss. BOSTON, MASSACHUSETTS

Then personally appeared Frank H. Pardee of Boston, Massachusetts, and made oath that he prepared and signed the foregoing petition and that the same is prepared with the consent of and in accordance with the request of the petitioner named therein, and that the allegations contained in said petition are true to the best of his knowledge and belief.

Before me,

Carl H. Kothe

Notary Public.

My commission expires April 20, 1929.

Supreme Court of the United States.

OCTOBER TERM, 1928.

No.

CARL H. KOTHE, TRUSTEE,
APPELLEE, PETITIONER HEREIN,
v.
R. C. TAYLOR TRUST,
APPELLANT, RESPONDENT HEREIN.

IN THE MATTER OF
HERBERT TURKEL, BANKRUPT.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

Statement of the Case.

The proceedings in this case are shown in full in the record and described, we believe, in sufficient detail in the petition (Pet. pars. 1 and 2).

The authority under which the jurisdiction of this Court is involved is stated in paragraph 3 of the petition.

The facts of the case are set forth as certified by the referee in said proof of claim (Rec. p. 3), but are more fully set forth in paragraphs 1 and 2 of the petition.

The controversy has reference to whether the provision in the lease under which the bankrupt occupied; namely:

> "The filing of any petition in bankruptcy—by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and

> without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor, shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof"—

makes the lease on its face and in essential nature in fraud of future creditors of the prospective bankrupt, and an attempt to nullify the Bankruptcy Act; and whether the provision is for a penalty, not liquidated damages.

Statement of the Question at Issue.

The specific questions, therefore, which the petitioner respectfully submits for the decision of this Honorable Court may be stated as follows:

Is the provision in the lease in essential nature in fraud of future creditors of the prospective bankrupt?

Is the provision in the lease for a penalty, and not for liquidated damages?

The Grounds for the Petition for Certiorari.

The grounds upon which the petitioner appeals to this Honorable Court for a writ of certiorari to the said Circuit Court of Appeals for the First Circuit are as stated in the petition, and are as follows:

SUMMARY OF ARGUMENT.

I. The questions involved in this case are questions of far-reaching importance to mercantile and business interests which have not been, but should be, settled conclusively by this Court.

II. The said Circuit Court of Appeals by the doctrine laid down by the majority opinion is untenable and in con-

flict with the weight of authority and the applicable decisions of this Court, and calls for the exercise of this Court's power of supervision.

III. The decision of said Circuit Court of Appeals is in conflict with the decisions of the Circuit Court of Appeals for the Sixth Circuit; in consequence it is desirable that the rule of law applicable be definitely and finally established by this Court.

Argument.

Point 1.

The question involved in the case is a question of far-reaching importance to mercantile and business interests which has not been, but should be, settled conclusively by this Court.

First. Judge Anderson in the first sentence of his dissenting opinion says: "This is an important case." By the decision of this case the status of contracts which tend to nullify the Bankruptcy Act will be determined. Although a lease is involved in the present case, the application of the principles of law involved are no different from any contract, for purchase and sale, for personal services, or whatnot. The determination of the question involved affects the entire business and mercantile world. It is common knowledge that most businesses are conducted in leased premises, and on a credit basis. The future creditors of businesses, whether such businesses are operated by corporations or by individuals, who are in the eyes of the Bankruptcy Act prospective bankrupts, should know what is the status of a contract such as the one in question, which is in essential nature a fraud on creditors.

Therefore your petitioner respectfully submits to this Honorable Court that the question involved is of great importance to mercantile and business interests, and it has not been, but should be, settled conclusively by this Court.

Point 2.

The said Circuit Court of Appeals by the doctrine laid down by the majority opinion is untenable and in conflict with the weight of authority and the applicable decisions of this Court so as to call for the exercise of this Court's power of supervision.

First. The provision of the lease under which the landlord, respondent, seeks to prove his claim is: "and, notwithstanding any other provisions of this lease the Lessor shall forthwith upon termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof." As Judge Anderson has so aptly said in his dissenting opinion (Rec. p. 18): "This is nothing but an agreement for proving non-accruing rent by simply calling it damages; it assumes that the Courts may be beguiled by an alias into disregarding realities." If "rent" were substituted for "damages" in the aforequoted provision of the lease, the decisions of the Circuit Courts of Appeals uniformly hold that the claim is not provable, so that the following is said to be the rule, in 4 Remington (3d), sec. 802: "If the landlord accepts the surrender of the leasehold or forfeits the residue of the term upon the bankruptcy, he waives his right to a claim for the rent for the unexpired portion of the term; for the Lessor cannot both have back his property and at the same time present a claim for the future installments of rent, and if he re-enters the premises or re-takes possession of the property so as permanently to exclude the Lessee from all future use thereof or otherwise terminate the lease, naturally, cannot prove for the future installments." *Wilson* v. *Pennsylvania Trust Co.*, 114 Fed. 742 (C.C.A. 3); *Rosenbloom* v. *Uber*, 256 Fed. 584 (C.C.A. (3); *In re Roth & Appel*, 181 Fed. 667 (C.C.A. 2); and *In re Miller Bros. Grocery Co.*, 219 Fed. 851 (C.C.A. 6).

Second. In another aspect of this question the provision in the lease was for a penalty, and not liquidated damages,

and the doctrine laid down by the majority opinion of said Circuit Court of Appeals favors a forfeiture or penalty which is contrary to well-established principles of law. The conclusion of the majority of said Court of Appeals is that the language in the lease plainly indicates that the parties intended that the sum agreed to be paid in case of a breach should be liquidated damages, and not a penalty. It is respectfully submitted that the intention of the parties to the contract is not the sole test of whether the sum stated in the contract is a provision for liquidated damages or a penalty. *Gay Manuf. Co.* v. *Camp,* 65 Fed. 794; *Lampman* v. *Cochran,* 16 N.Y. 275; *Tayloe* v. *Sandiford,* 7 Wheat. 13; and *Sun Printing & Publishing Association* v. *Moore,* 183 U.S. 642. Even if the Court ascertained beyond a doubt that the intention of the contracting parties was to regard the future rent as liquidated damages, the Court should further inquire, it is respectfully submitted, whether the enforcing of such provision would reach the element of exorbitance (*Maryland Dredging Co.* v. *United States,* 241 U.S. 184), illegality, or fraud.

As was said in *United States* v. *Bethlehem Steel Co.*, 205 U.S. 105, at page 119: "When such intention [intention of the contracting parties] is ascertained it is ordinarily the duty of the Court to carry it out." In all the cases where the Courts have enforced the contract, even though the case seemed a hard one, the person against whom the agreement was sought to be enforced was one of the contracting parties. The attention of the Court is respectfully invited to the fact that in this case the lessee is not the one who will suffer by the enforcement of this provision, but his innocent creditors, whose goods constitute the major portion of his estate, and who, in the contemplation of the Bankruptcy Act, are entitled to receive equitable distribution of the bankrupt's estate. It is further respectfully submitted that the elements of fraud and deception are so patent that the Courts should not countenance the enforcement of

a contract of this nature. *Maryland Dredging Co.* v. *United States, supra.*

Peckham, J., says in *United States* v. *Bethlehem Steel Co., supra:* "The Courts at one time seemed to be quite strong in their views and would scarcely admit that there ever was a valid contract providing for liquidated damages. Their tendency was to construe the language as a penalty, so that nothing but the actual damages sustained by the party aggrieved could be recovered." Although the attitude of the Courts, it would seem, has changed as to contracting parties, it is respectfully submitted that, where the rights of innocent third persons are involved and it is a matter for equitable distribution of a bankrupt estate, the attitude of the Court should be as Peckham, J., says it formerly was when the Courts were construing the contract as between the contracting parties.

Therefore the petitioner repectfully submits to this Honorable Court that the said Circuit Court of Appeals for the First Circuit has decided the case in a way that is untenable and in conflict with the weight of authority and the applicable decisions of this Court so as to call for the exercise of this Court's power of supervision.

Point 3.

The decision of said Circuit Court of Appeals is in conflict with the decisions of the Circuit Court of Appeals for the Sixth Circuit; in consequence it is desirable that the rule of law applicable be definitely and finally established by this Court.

First. The Circuit Court of Appeals for the Sixth Circuit had exactly the same question to decide in the case of *In re Miller Bros. Grocery Co.*, 219 Fed. 851 (C.C.A. 6) as was decided in this case. The Miller Bros. Grocery Company and the Lamson Consolidated Store Service Company executed on November 15, 1911, a contract under which the Grocery Company had installed a cash-carrier system by

the Store Service Company. The lessee was to use the system on its premises for seven years from the date of installation. The lessee was to pay rental quarterly in advance on the 1st days of March, June, September, and December in each year at the rate of $250 per annum. January 19, 1912, the lessee paid the rental for the time between the date of installation and March 1st; on that date the first quarterly instalment became payable (in advance); but that sum was not paid, nor was anything further paid on account of rent. On May 16, 1912, an involuntary petition in bankruptcy was filed against the Grocery Company. Adjudication followed, and a trustee was duly elected. During August, 1912, the Lamson Company took possession of the carrier and removed it, and, on August 26, 1912, after removing the carrier, filed its proof of debt, including in its proof the total rental for the seven years, less the payments made. The referee disallowed the claim, and upon review the District Court reversed the order of the referee and allowed the entire claim.

Says Warrington, J., at page 852:

> "The question is whether the Lamson Company was entitled both to take back the carrier system and insist upon allowance of its entire claim. The lease provides:
>
> "Paragraph 3 '. . . If any installment of rental shall remain unpaid for 60 days after it becomes due, the entire rental to the end of this lease shall become at once payable without demand.'
>
> "Paragraph 6 'And these presents are upon this condition that in case of a breach by Lessee of any of the covenants or agreements herein, or in case the Lessee becomes bankrupt, insolvent or makes an assignment for the benefit of creditors, or discontinues business in the premises for any other reason whatsoever, the balance of rental for the entire term of this lease shall be considered at once due and payable without notice or demand on the part of the Lessor; and it

is also provided that the Lessor may at any time after such breach of this lease occurs, enter the premises, take possession of said system, and thereby terminate all rights and interests of the Lessee in said system.' "

At page 853. "It results that the Lessor's theory savors of forfeiture of substantial rights of the Lessee, and it need not be said that forfeitures are not favored. It is conceded that, if the subject of the lease were real estate, re-entry of the Lessor would put an end to the Lessee's liability to pay unearned rent; and it ought to follow that if the instrument in issue is to be treated as a lease, a like conclusion should be reached here."

The decision of the District Court was reversed.

Although, because of certain aspects of *In re Miller Bros. Grocery Co., supra,* the language quoted might be considered dictum, that the Court did not so intend it is shown by its opinion in *Lamson Co.* v. *Elliott, Taylor, Woolfenden Co. et al.,* 25 Fed. (2d) 4 (C.C.A. 6). At page 6 says Denison, J.:

"The decision of this Court in the Miller case might well be considered as critically depending upon the conclusion that the two rights were alternatively given, and so it might be thought that what is said about invalidity through the forfeiture element was dictum; and yet the discussion and conclusion as to the validity of a promise to pay the remaining payments in spite of re-entry, were persuasive in leading the Court to take the final step, and we are not inclined to disregard, as merely dicta the things said about validity."

Therefore it is respectfully submitted that the conflict between the decisions of the First and Sixth Circuit Courts of Appeals upon the identical questions of law is apparent;

and this Honorable Court, never having had occasion to settle the question, should now settle it definitely and finally.

Conclusion.

It is most respectfully submitted to this Honorable Court that the question involved in this case is of great importance in the administration of the Bankruptcy Act and of great interest to the mercantile and business interests; that there is conflict between two Circuit Courts of Appeals thereon; that this case was decided by a divided Court, Judge Anderson filing a dissenting opinion, full of forceful and logical language and reasoning; that in view of these aspects of the case as well as the disagreement between the District Court and the Circuit Court of Appeals, and for all the other reasons above pointed out, it is respectfully submitted that the writ of certiorari should issue; that the decree of the Circuit Court of Appeals for the First Circuit should be reversed, and that of the District Court affirmed.

Respectfully submitted,
FRANK H. PARDEE,
Attorney for Petitioner.